PART I

Item 1. Business

THE COMPANY

The Diamond State Telephone Company (Company) is incorporated under the laws of the State of Delaware and has its principal offices at 911 Tatnall Street, Wilmington, Delaware 19801 (telephone number 302-427-7750). The Company is a wholly-owned subsidiary of Bell Atlantic Corporation (Bell Atlantic).

The Company presently serves a territory consisting of one Local Access and Transport Area (LATA). This LATA consists of the State of Delaware and includes telecommunications transport to the Philadelphia metropolitan area. This LATA marks the boundary within which the Company may provide telephone service.

The Company provides two basic types of telecommunications services. First, the Company transports telecommunications traffic between subscribers located within the same LATA (e.g., intraLATA local and intrastate toll service and intraLATA interstate toll service). Second, the Company provides access service, which links a subscriber's telephone or other equipment to the transmission facilities of interexchange carriers which, in turn, provide telecommunications service between LATAs (interLATA service) or within the LATA (intraLATA service). (See "Competition - IntraLATA Competition" and "Line of Business Restrictions".)

OPERATIONS

The Company's lines of business comprise Local Service, Network Access, Toll Service, and Directory, Billing and Other Services. Local Service includes the provision of local exchange ("dial tone"), local private line, and public telephone services, including service for both Bell Atlantic-owned and customer-provided coin telephones. Among other services provided in this category are Centrex (central office-based switched telephone service enabling the subscriber to make both intercom and outside calls) and a variety of special and custom calling services. Network Access is the provision of access to the local exchange network for switched transmissions to interexchange carriers and other customers and the provision of dedicated circuits for voice and data transmissions to interexchange carriers and other customers. Toll Service includes message toll telephone service (MTS) (calling service beyond the local calling area) within LATA boundaries and intraLATA Wide Area Toll Service (WATS)/800 services (volume discount offerings for customers with highly concentrated demand). Directory, Billing and Other Services includes directory publishing (both Yellow Pages and White Pages), billing services for interexchange and other carriers and information service providers, and customer premises services such as inside wire installation and maintenance. The Company also provides various operator services.

On September 10, 1987, the Court issued an opinion eliminating the prohibition on entering into any non-telecommunications business. However, the Court refused to eliminate the restrictions relating to manufacturing or providing interexchange services. With respect to information services, the Court issued an opinion on March 7, 1988 which permitted the RHCs to engage in a number of information transport functions as well as voice storage and retrieval services, including voice messaging and electronic mail offerings and certain information gateway services. The RHCs were generally prohibited, however, from providing the content of the data they transmit. As the result of an appeal by Bell Atlantic, the other RHCs and other parties of the Court's September 10, 1987 decision, the Court of Appeals ordered the Court to reconsider the RHCs' request to provide information content under a standard more favorable to the RHCs. On July 25, 1991, the Court granted that request, but imposed a stay pending appeal of that decision. On October 7, 1991, the Court of Appeals vacated the stay, permitting the RHCs to provide information services.

FCC REGULATION AND INTERSTATE RATES

The Company is subject to the jurisdiction of the Federal Communications Commission (FCC) with respect to interstate services and certain related matters. The FCC prescribes a uniform system of accounts for telephone companies, interstate depreciation rates and the principles and standard procedures used to separate plant investment, expenses, taxes and reserves between those applicable to interstate services under the jurisdiction of the FCC and those applicable to intrastate services under the jurisdiction of the respective state regulatory authorities (separations procedures). The FCC also prescribes procedures for allocating costs and revenues between regulated and unregulated activities.

Interstate Access Charges

The Company provides intraLATA service but does not participate in the provision of interLATA service except through offerings of exchange access service. The FCC has prescribed structures for the Company's interstate exchange access tariff to specify the charges (Access Charges) for use of the Company's facilities used or available for the origination and termination of interstate interLATA service. These charges are intended to recover the related costs of the Company which have been allocated to the interstate jurisdiction (Interstate Costs) under the FCC's separations procedures.

In general, the tariff structures prescribed by the FCC provide that Interstate Costs of the Company which do not vary based on usage (non-traffic sensitive costs) are recovered from subscribers through flat monthly charges (Subscriber Line Charges), and from interexchange carriers or other access customers through a usage sensitive Carrier Common Line (CCL) charge (see "FCC Access Charge Pooling Arrangements"). Traffic-sensitive Interstate Costs are recovered from carriers or other access customers through variable access charges based on several factors, primarily usage.

depreciation reserve deficiencies over a five-year period, retroactive to January 1, 1987. The FCC had previously authorized the amortization of these differences by the Company over a shorter period. In August 1991, the FCC ordered the Company to amortize the remaining balance of the reserve deficiencies over the period from July 1, 1991 to June 30, 1992.

Interstate Access Rate of Return

Pursuant to rules it adopted in 1985 and 1986, the FCC prescribes the rate of return on the interstate access services of LECs such as the Company. The FCC has set an 11.25 percent return for 1991 and beyond. This rate of return serves as a benchmark for regulation of the Company under price cap regulation. (See "Price Caps".)

The FCC had also adopted rate of return enforcement rules, which required carriers to target their rates to produce the prescribed return and to automatically refund earnings in excess of their allowable return (the prescribed target return plus an increment of 25 basis points on overall earnings or 40 basis points on each of three categories of service). On January 22, 1988, the U.S. Court of Appeals for the District of Columbia Circuit held that the FCC's automatic refund rule was arbitrary and capricious, and remanded the case to the FCC so that it could, if it wished, promulgate a new refund rule. The FCC subsequently stayed indefinitely any requirement that carriers refund excess earnings for the initial enforcement period (October 1985 through December 1986), during which time the prescribed rate of return was 12.75 percent. The FCC has taken no action to revise its enforcement rules. The FCC has, however, permitted access customers to file complaints for damages in which the damages are calculated in accordance with the FCC's automatic refund methodology. Appeals of the FCC's rulings permitting such complaints to be filed were dismissed as premature. The Company has settled the major complaints.

Under FCC-approved tariffs, all of the Bell Atlantic telephone companies are charging uniform rates for interstate access services (with the exception of Subscriber Line Charges) in all Bell Atlantic jurisdictions, and are regarded as a single unit by the FCC for rate of return measurement.

Price Caps

On September 19, 1990, the FCC adopted "price cap" regulation as a replacement for traditional rate of return regulation for LECs, such as the Company. The new system places a cap on overall prices for interstate services and requires that the cap decrease annually, in inflation-adjusted terms, by a fixed amount which is intended to reflect expected increases in productivity. The price cap level can also be adjusted to reflect "exogenous" changes, such as changes in FCC separations or accounting rules. LECs subject to price caps have somewhat increased flexibility to change the prices of existing services within certain groupings of interstate services, known as "baskets".

FCC Cost Allocation Rules

In 1987, the FCC adopted rules governing (1) the allocation of costs between regulated and nonregulated activities and (2) transactions with affiliates. Pursuant to those rules, the Company has filed a cost allocation manual which has been approved by the FCC.

The cost allocation rules apply to activities that have never been regulated as communications common carrier offerings and to activities that have been pre-emptively deregulated by the FCC. The costs of these activities are removed prior to the separations process and are allocated to non-regulated activities in the aggregate, not to specific services for pricing purposes. Other activities must be accounted for as regulated activities, and their costs will be subject to separations. These include (1) activities which have been deregulated by the FCC without pre-empting state regulation, (2) activities which have been deregulated by a state but not the FCC and (3) "incidental activities," which cannot, in the aggregate, produce more than 1% of a company's revenues.

The affiliate transaction rules generally require that assets be transferred between affiliates at market price, if such price can be established through a tariff or a prevailing price charged to third parties. In the absence of such information, transfers from a regulated to an unregulated affiliate must be valued at the higher of cost or fair market value, and transfers from an unregulated to a regulated affiliate must be valued at the lower of cost or fair market value. Services provided to an affiliate must be valued at tariff rates, or market prices if the service is also provided to unaffiliated entities.

The FCC has not made its rules pre-emptive. State regulatory authorities are free to use different cost allocation methods and affiliate transaction rules for intrastate ratemaking, and to require carriers to keep separate allocation records.

Telephone Company/Cable Television Cross-Ownership

In 1987, the FCC initiated an inquiry into whether developments in the cable and telephone industries warranted changes in the "cross-ownership" rules prohibiting telephone companies such as the Company from providing cable service in their service territories directly or indirectly through an affiliate.

On November 22, 1991, the FCC released a Further Notice of Proposed Rulemaking (FNPRM) in its cross-ownership proceedings. The FNPRM proposes to permit telephone companies such as the Company to provide video dial tone service on a common carrier basis.

The FCC also released a First Report and Order (Order) and a Second Further Notice of Inquiry (FNOI). In the Order, the FCC ruled that neither telephone companies that provide video dial tone service, nor video programmers that use these services, are required to obtain local cable franchises. The FNOI asks for comments on whether the FCC should recommend to Congress any changes in the statute prohibiting telephone companies from providing cable service in their telephone service areas.

In April 1988, in Phase I of a Delaware Public Service Commission (PSC) rate investigation in Docket 86-20, the PSC found that the Company's cost of equity was 12.00%, which corresponds to a 10.72% overall rate of return.

The Phase II rate structure proceeding, which resulted in reductions to permanent rates, began in the fourth quarter of 1988 and concluded in the fourth quarter of 1990. In June 1989, the PSC Staff also proposed rate structures which involved redesigning local and toll calling areas. In November 1990, the PSC approved the Delaware Regional Call Plan which expanded local calling areas almost to county boundaries, maintained dial tone line rates at existing levels and significantly reduced local usage and toll rates. These changes, as well as all Docket 86-20 permanent rate changes, went into effect on January 1, 1991.

On March 19, 1991, the PSC ruled that MTS, WATS, 800, and Private Line services should be open to competition in Delaware. The PSC also determined that both the Company and its competitors could seek changes in rates for competitive services using streamlined procedures. In December 1991, the PSC approved the Company's request for rate changes for its intrastate MTS effective January 1, 1992. These rate changes are expected to increase intrastate revenues by approximately $1.9 million.

In August 1991, the PSC approved depreciation rates recommended by the PSC Staff and the Company as part of the triennial review. The same rates were recommended by the FCC Staff and subsequently approved by the FCC. The new depreciation rates, which were made effective as of January 1, 1991, will result in increased annual depreciation expense in future years. The amount of such increase was estimated at $3.7 million for 1991.

NEW PRODUCTS AND SERVICES

Bell Atlantic® I.Q.℠ Services

The Company has introduced or is in the process of introducing several of the Bell Atlantic® I.Q.℠ Services family of calling features. These features include Identa Ring℠, which allows a single line to have multiple telephone numbers, each with a distinctive ring; Caller ID, which displays the number of the calling party; Repeat Call, which allows customers automatically to redial busy phone numbers; and Return Call, which allows customers automatically to return the last incoming call, even without knowing the number.

Gateway Services

The Company is continuing its trials of Gateway Services. Gateway Services provide a single point of entry for users of personal computers to gain access to multiple databases.

would compete with services currently offered by the Company, and could result in losses of revenues to the Company, although the Company may be able to derive new revenues if it obtains authorization to provide PCS or similar new services. If PCS is implemented, the FCC is expected to authorize more than a single service provider in each geographic area.

Centrex

The Company offers Centrex service, which is a central office-based communications system for business, government and other institutional customers consisting of a variety of integrated software-based features located in a centralized switch or switches and extended to the customer's premises primarily via local distribution facilities. In the provision of Centrex, the Company encounters increasing competition from the providers of CPE systems, such as private branch exchanges (PBXs), which perform similar functions with less use of the Company's switching facilities.

Users of Centrex systems generally require more subscriber lines than users of PBX systems of similar capacity. The FCC increased the maximum Subscriber Line Charge on embedded Centrex lines to $6.00 effective April 1, 1989. Increases in Subscriber Line Charges result in Centrex users incurring higher charges than users of comparable PBX systems. The PSC has permitted flexible pricing for certain Centrex services which helps to offset the effects of such higher Subscriber Line Charges.

IntraLATA Competition

The ability of interexchange carriers to engage in the provision of intrastate intraLATA services in competition with the Company is subject to state regulation by the PSC. In 1991 the PSC determined that MTS, WATS, 800 and Private Line Services should be open to competition in Delaware.

Directory

The Company's directory operations continue to face significant competition from other providers of directories, as well as competition from the advertising media. In particular, the former sales representative of several of Bell Atlantic's telephone subsidiaries publishes directories competitive with those produced by the Company.

Coin Telephone Service

The Company faces increasing competition in the provision of coin telephone services.

Operator Services

Alternative operator services providers have entered into competition with the Company's operator services product line.

Item 2. Properties

The principal properties of the Company do not lend themselves to simple description by character and location. At December 31, 1991, the Company's investment in plant, property and equipment consisted of the following:

Connecting lines	50%
Central office equipment	37
Land and buildings	6
Telephone instruments and related equipment	3
Other	4
	100%

"Connecting lines" consists primarily of aerial cable, underground cable, poles, conduit and wiring. "Central office equipment" consists of switching equipment, transmission equipment and related facilities. "Land and buildings" consists of land owned in fee and improvements thereto, principally central office buildings. "Telephone instruments and related equipment" consists primarily of public telephone terminal equipment and other terminal equipment. "Other" property consists primarily of furniture, office equipment, vehicles and other work equipment, capital leases, leasehold improvements and plant under construction.

All of the Company's central offices were served by electronic switching equipment at December 31, 1991 and 1990.

An analysis of the estimated components of the Company's construction program for the last two years is as follows:

	(In Millions)	
	1991	1990
Network growth	$ 22.8	$ 26.2
Network modernization	12.4	9.9
Market specific	9.7	5.0
Network replacement	3.4	4.2
Network support	2.0	2.4
Operations support systems	0.5	0.2
	50.8	47.9
Allowance for funds used during construction	0.1	0.1
Total construction program	$ 50.9	$ 48.0

Item 4. Submission of Matters to a Vote of Security Holders. (Omitted pursuant to General Instruction J(2).)

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters. (Inapplicable.)

Item 6. Selected Financial Data. (Omitted pursuant to General Instruction J(2).)

lines in service to approximately 429,000 lines at year-end; however, this growth rate declined from 3.1% during 1990 due to the weakened economy.

On November 2, 1990, the PSC completed Docket No. 86-20 rate structure proceedings and ordered, effective January 1, 1991, new tariff rates to replace the temporary 20.0% negative surcharge in effect since January 1, 1989. The new rate structure expanded local calling areas to include almost all subscribers within the caller's county (i.e., Delaware Regional Call Plan), maintained dial tone line rates at existing levels and significantly reduced local usage rates and toll rates. The replacement of the negative surcharge with new tariff rates did not have a material impact on the Company's operating results in 1991. However, the expansion of local calling areas caused an increase in local service revenues and a corresponding decrease in intrastate toll service revenues when compared to 1990.

Network access revenues are earned from interexchange carrier customers (IXCs) for their use of local exchange facilities to provide interstate and intrastate long distance services and from end-user customers. Effective January 1, 1991, the Federal Communications Commission (FCC) adopted price cap regulation and lowered the authorized rate of return for interstate access services from 12.0% to 11.25%. Price caps, a form of incentive regulation, limit prices rather than profits. The FCC's price cap plan includes a sharing provision whereby interstate earnings above certain thresholds (e.g., 12.25% rate of return) are shared equally with customers, while earnings above substantially higher thresholds (e.g., 16.25% rate of return) are returned entirely to customers. Sharing occurs in the form of temporary prospective rate decreases. The Company reduced its rates on interstate access services on January 1, 1991 to reflect the lower authorized rate of return. In its first Annual Price Cap Tariff filing, effective July 1, 1991, the Company further reduced its rates. These two rate reductions did not have a material impact on 1991 operating revenues.

Network access revenues increased primarily due to a 5.4% growth in network access minutes of use to 1.3 billion minutes for 1991. Partially offsetting the revenue increase were lower prices resulting from the above mentioned rate reductions and a $2.1 million increase in the Company's allocable share of Bell Atlantic's continuing obligation to the National Exchange Carrier Association Pool.

Toll service revenues are earned from the provision of long distance communication services. Toll service revenues decreased in 1991 primarily due to the previously mentioned PSC Docket No. 86-20 tariff rate changes, effective January 1, 1991. Specifically, the PSC approved a reduction of approximately 65.0% in the rates for message toll service and expanded local calling areas to include almost all subscribers within the caller's county.

On March 19, 1991, the PSC ruled that Message Toll, Wide Area Telecommunications (WATS), 800, and Private Line services should be open to competition in Delaware. The PSC also determined that both the Company and its competitors could seek changes in rates for competitive services using streamlined procedures. In December 1991, the PSC allowed the Company's request for rate changes for its intrastate Message Toll Service, effective January 1, 1992. These rate changes are expected to increase intrastate revenues by approximately $1.9 million in 1992.

Other operating expenses consist primarily of contracted services, including centralized staff costs allocated from NSI, rents, operating taxes other than income taxes, and other general and administrative expenses. Other operating expenses include approximately $1.5 million of restructure related costs associated with the retirement incentive program. Other operating expenses also increased in 1991 primarily due to higher costs for contracted services and telephone directory production. The Company implemented cost reduction efforts in 1991, in response to the weakened economy, which reduced the rate of growth in other operating expenses.

OPERATING INCOME TAXES

Operating income taxes for the year ended December 31, 1991 decreased $3.7 million, or 15.5%, compared to 1990. The decrease was primarily due to lower pretax income.

The Company's effective income tax rate was 36.3% for 1991 compared to 39.0% for 1990. A reconciliation of the federal statutory rate to these effective rates is included in Note 5 of Notes to Financial Statements. A discussion of the prospective impact of the Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," is also included therein.

INTEREST EXPENSE

Interest expense for the year ended December 31, 1991 decreased $808,000, or 9.4%, compared to the same period last year. The decrease was primarily due to interest expense recorded in 1990 in connection with estimated revenue liabilities.

FEDERAL REGULATORY DEVELOPMENTS

In June 1991, the FCC released a Notice of Proposed Rule Making (NPRM) which proposes to allow third parties to collocate their equipment in, or very near, telephone company offices to provide special access (private line) services to the public. The FCC's stated purpose for the proposed rulemaking is to encourage greater competition in the provision of interstate special access services. The FCC has tentatively concluded that collocating parties would pay the telephone company an interconnection charge that is lower than the existing tariffed rates for similar non-collocated services. In the same release, the FCC issued a Notice of Inquiry (NOI) asking what policies it should adopt in regard to interstate switched access collocation. Comments and replies to the NPRM and NOI have been filed by the Network Service Companies and others. The FCC has not reached a final decision in either part of the proceeding, nor can the Company predict when such a decision will be made.

If the FCC permits increased competition by allowing collocation, the revenues of the Company would be adversely effected, although some of the lost revenues could be offset by increased demand if, as the local exchange carriers requested in their comments, the FCC provides them with greater pricing flexibility. Collocation for the provision of switched access services would result in greater

Item 8. Financial Statements and Supplementary Data.

The information required by this Item is set forth on pages F-1 through F-32.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

PART III

Item 10. Directors and Executive Officers of Registrant. (Omitted pursuant to General Instruction J(2).)

Item 11. Executive Compensation. (Omitted pursuant to General Instruction J(2).)

Item 12. Security Ownership of Certain Beneficial Owners and Management. (Omitted pursuant to General Instruction J(2).)

Item 13. Certain Relationships and Related Transactions. (Omitted pursuant to General Instruction J(2).)

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.

(a) Documents filed as a part of the report:

(1) Financial Statements:

See Index to Financial Statements and Financial Statement Schedules appearing on Page F-1.

(2) Financial Statement Schedules:

See Index to Financial Statements and Financial Statement Schedules appearing on Page F-1.

(3) Exhibits

Exhibits identified in parentheses below, on file with the Securities and Exchange Commission (SEC), are incorporated herein by reference as exhibits hereto.

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THE DIAMOND STATE TELEPHONE COMPANY

By /s/ R. J. McGonagle
R. J. McGonagle
Controller and Treasurer

March 26, 1992

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Principal Executive Officer:

C. S. Burger
President and Chief Executive Officer

Principal Financial and Accounting Officer:

R. J. McGonagle
Controller and Treasurer

Directors:

Harry Bonk
Carolyn S. Burger
Charles W. Crist
Archie W. Dunham
Joshua W. Martin, III
Hugh E. Miller
Robert F. Rider
David P. Roselle

By /s/ R.J. McGonagle
R. J. McGonagle
(individually and as attorney-in-fact)

March 26, 1992

REPORT OF MANAGEMENT

The management of The Diamond State Telephone Company is responsible for the information and representations contained in this report. Management believes that the financial statements have been prepared in conformity with generally accepted accounting principles and that the other information in this report is consistent with those statements. Management is required to include in the financial statement amounts, primarily relating to matters not concluded by year-end, which are based on management's best estimates and judgments.

In meeting its responsibility for the financial statements of the Company, management maintains a strong internal control structure, including the appropriate control environment, accounting systems and control procedures. The internal control structure is designed to provide reasonable assurance that assets are safeguarded from unauthorized use or disposition, that transactions are properly recorded and executed in accordance with management's authorization and that the financial records permit the preparation of reliable financial statements. There are, however, inherent limitations that should be recognized in considering the assurances provided by the internal control structure. The concept of reasonable assurance recognizes that the costs of the internal accounting control structure should not exceed the benefits to be derived. The internal control structure is reviewed and evaluated on a regular basis. Compliance is monitored by the internal auditors through an annual plan of internal audits.

The Board of Directors pursues its review and oversight role for these financial statements through an Audit Committee composed of three outside directors. The Audit Committee's duties include recommending to the Board of Directors the appointment of an independent accounting firm to audit the financial statements of the Company. The Audit Committee meets periodically with management and the Board of Directors. It also meets with representatives of the internal and independent auditors and reviews the work of each to ensure that their respective responsibilities are being carried out and to discuss related matters. Both the internal and independent auditors have direct access to the Audit Committee.

The financial statements of the Company have been audited by Coopers & Lybrand, independent accountants, whose report is included on the following page.

/s/ Robert J. McGonagle

Robert J. McGonagle
Controller and Treasurer

THE DIAMOND STATE TELEPHONE COMPANY
STATEMENTS OF INCOME AND REINVESTED EARNINGS
FOR THE YEARS ENDED DECEMBER 31,

(Dollars in Thousands)

	1991	1990	1989
OPERATING REVENUES			
Local service	$ 98,571	$ 87,991	$ 84,968
Network access	60,807	58,209	55,904
Toll service	34,420	43,552	38,223
Directory advertising, billing services and other	38,552	38,615	35,492
Provision for uncollectibles	(1,962)	(1,893)	(1,502)
	230,388	226,474	213,085
OPERATING EXPENSES			
Employee costs, including benefits and taxes	53,163	51,912	56,978
Depreciation and amortization	39,165	34,063	31,602
Other	75,149	71,097	66,718
	167,477	157,072	155,298
Net operating revenues	62,911	69,402	57,787
OPERATING INCOME TAXES			
Federal	14,734	17,824	13,061
State	5,352	5,957	4,720
	20,086	23,781	17,781
Operating income	42,825	45,621	40,006
OTHER INCOME (EXPENSE)			
Allowance for funds used during construction	65	103	147
Miscellaneous – net	(275)	(353)	(902)
	(210)	(250)	(755)
INTEREST EXPENSE	7,763	8,571	9,684
INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	34,852	36,800	29,567
C[redacted]HANGE IN [redacted]unting [redacted]7,233)	(26,129)	--	--
NET INCOME	$ 8,723	$ 36,800	$ 29,567
REINVESTED EARNINGS			
At beginning of year	$ 63,815	$ 54,073	$ 58,460
Add net income	8,723	36,800	29,567
	72,538	90,873	88,027
Deduct: dividends	32,267	26,973	33,911
other changes	26	85	43
At end of year	$ 40,245	$ 63,815	$ 54,073

The accompanying notes are an integral part of these financial statements.

THE DIAMOND STATE TELEPHONE COMPANY
BALANCE SHEETS
AS OF DECEMBER 31,

(Dollars in Thousands)

	1991	1990
LIABILITIES AND SHAREOWNER'S INVESTMENT		
CURRENT LIABILITIES		
Debt maturing within one year:		
Affiliate	$ 2,500	$ 1,472
Other	30	28
Accounts payable:		
Affiliates	8,436	17,018
Other	26,859	20,495
Accrued expenses:		
Taxes	2,863	3,668
Interest	1,563	2,010
Vacation pay	3,308	3,439
Other	3,385	3,493
Advance billing, customer deposits and other	14,848	22,534
	63,792	74,157
LONG-TERM DEBT	104,198	89,362
DEFERRED CREDITS		
Deferred income taxes	57,423	75,928
Unamortized investment tax credits	13,016	14,471
Employee benefit obligations	47,568	3,472
Other	2,693	1,882
	120,700	95,753
CONTINGENCIES		
SHAREOWNER'S INVESTMENT		
Common stock, $25 par value per share Authorized shares: 5,262,280 Outstanding shares: 4,737,686	118,442	118,442
Reinvested earnings	40,245	63,815
	158,687	182,257
TOTAL LIABILITIES AND SHAREOWNER'S INVESTMENT	$ 447,377	$ 441,529

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The Diamond State Telephone Company (the Company), a wholly-owned subsidiary of Bell Atlantic Corporation (Bell Atlantic), maintains its accounts in accordance with the Uniform System of Accounts (USOA) prescribed by the Federal Communications Commission (FCC) and makes certain adjustments necessary to present the accompanying financial statements in accordance with generally accepted accounting principles applicable to regulated entities. Such principles differ in certain respects from those used by unregulated entities, but are required to appropriately reflect the financial and economic impacts of regulation and the ratemaking process. Significant differences resulting from the application of these principles are disclosed elsewhere in these Notes to Financial Statements where appropriate.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of 90 days or less when purchased to be cash equivalents. Cash equivalents are stated at cost, which approximates market value.

Material and Supplies

New and reusable materials are carried in inventory, principally at average original cost, except that specific costs are used in the case of large individual items. Nonreusable material is carried at estimated salvage value.

Plant and Depreciation

The Company's provision for depreciation is based principally on the remaining life method of depreciation and straight-line composite rates. This method provides for the recovery of the remaining net investment in telephone plant, less anticipated net salvage value, over the remaining service lives authorized by federal and state regulatory authorities. Depreciation expense also includes amortization of certain classes of telephone plant and certain identified depreciation reserve deficiencies over periods authorized by regulatory authorities.

When depreciable plant is replaced or retired, the amounts at which such plant has been carried in plant, property and equipment accounts are removed from the respective accounts and charged to accumulated depreciation, and any gains or losses on dispositions, with the exception of the gain or loss on the sale of land or buildings, are amortized over the remaining service lives of the remaining net investment in telephone plant.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

Bell Atlantic and its domestic subsidiaries, including the Company, file a consolidated federal income tax return. The consolidated income tax currently payable is allocated in accordance with each subsidiary's contribution to consolidated taxable income and tax credits.

Deferred income taxes generally are provided to reflect the effect of timing differences in the recognition of revenue and expense for financial and income tax reporting purposes.

The Tax Reform Act of 1986 repealed the investment tax credit (ITC) as of January 1, 1986, subject to certain transitional rules. Realized ITC's were deferred and are being amortized to income over the estimated service lives of the related assets.

Reclassifications

Certain reclassifications of prior years' data have been made to conform to 1991 classifications.

2. DEBT (Continued)

Maturing Within One Year

Debt maturing within one year consists of the following at December 31:

				Weighted Average Interest Rates		
	1991	1990	1989	1991	1990	1989
	(Dollars in Thousands)					
Note payable to affiliate..	$ 2,500	$ 1,472	$ 1,800	4.9%	7.9%	9.5%
Capital lease obligations..	30	28	12			
Total	$ 2,530	$ 1,500	$ 1,812			
Average amounts of notes payable outstanding during the year*	$ 1,863	$ 1,538	$ 2,075	6.0%	8.2%	9.3%
Maximum amounts of notes payable at any month-end during the year	$ 9,078	$ 9,610	$ 13,223			

* Amounts represent average daily face amounts of notes. Weighted average interest rates are computed by dividing such amounts into the aggregate related interest expense.

At December 31, 1991, the Company had an unused line of credit balance of $25.3 million with an affiliate, Bell Atlantic Network Funding Corporation (see Note 11).

4. LEASES

The Company has entered into both capital and operating leases as lessee for facilities and equipment used in operations. The Company did not incur any capital lease obligations in 1991, 1990 or 1989.

Total rent expense was $6.1 million in 1991, $4.9 million in 1990, and $8.7 million in 1989. Of these amounts, the Company incurred rent expense of $3.9 million, $3.2 million and $6.3 million in 1991, 1990 and 1989, respectively, from The Bell Telephone Company of Pennsylvania, an affiliated company.

At December 31, 1991, the approximate aggregate minimum rental commitments under non-cancelable leases for the periods shown are as follows:

(Dollars in Thousands)

Years	Capital Leases	Operating Leases
1992	$ 32	$ 507
1993	--	507
1994	--	472
1995	--	330
1996	--	117
Thereafter	--	--
Total	32	$ 1,933
Less imputed interest	2	
Present value of net minimum lease payments	30	
Less current installments	30	
Long-term obligation at December 31, 1991	$ --	

5. INCOME TAXES (Continued)

The provision for income taxes varies from the amount computed by applying the statutory federal income tax rate to income before provision for income taxes and cumulative effect of change in accounting principle. The difference is attributable to the following factors:

	Years Ended December 31,		
	1991	1990	1989
Statutory federal income tax rate	34.0%	34.0%	34.0%
Investment tax credits	(2.8)	(2.0)	(2.9)
State income taxes, net of federal income tax benefits	6.4	6.5	6.5
Benefit of rate differential applied to reversing timing differences	(2.0)	(1.4)	(1.6)
Reversal of previously capitalized taxes and payroll-related construction costs	0.9	0.8	1.1
Other differences, net	(0.2)	1.1	(0.3)
Effective tax rate before cumulative effect of change in accounting principle	36.3%	39.0%	36.8%

As a result of the adoption, effective January 1, 1988, of the revised Uniform System of Accounts prescribed by the Federal Communications Commission, deferred taxes must be provided for interstate ratemaking purposes on all future book/tax timing differences. Prior to 1988, the Company did not record deferred taxes on timing differences for which deferred tax expense was not allowed for ratemaking purposes.

The cumulative net amount of income tax timing differences for which deferred taxes have not been provided pursuant to the ratemaking process was approximately \$2.0 million and \$3.1 million at December 31, 1991 and 1990, respectively. These timing differences principally relate to the allowance for funds used during construction and certain taxes and payroll-related construction costs capitalized for financial statement purposes, but deducted currently for income tax purposes, net of applicable depreciation. At December 31, 1991 and 1990, deferred state income taxes have not been provided on an additional \$39.7 million and \$44.8 million, respectively, of income tax timing differences, principally related to accelerated tax depreciation.

6. EMPLOYEE RETIREMENT BENEFITS

Pension Plans

Substantially all of the Company's management and associate employees are covered under noncontributory multi-employer pension and death benefit retirement plans sponsored by Bell Atlantic and certain of its subsidiaries, including the Company. The pension benefit formula is based on a flat dollar amount per year of service according to job classification under the associate plan and a stated percentage of adjusted career average income under the plans for management employees. The Company's objective in funding the plans is to accumulate funds at a relatively stable rate over participants' working lives so that benefits are fully funded at retirement. Plan assets consist principally of investments in domestic and nondomestic corporate equity securities, U.S. Government and corporate debt securities, and real estate.

Aggregate pension costs for the plans are as follows:

	Years Ended December 31,		
	1991	1990	1989
	(Dollars in Thousands)		
Current year cost..............	$ 1,983	$ 1,914	$ 2,402
Percent of salaries and wages..	4.4%	4.4%	6.1%

During 1991, the Company offered a retirement incentive program to eligible management employees electing early retirement. The increase in pension cost from 1990 to 1991 is primarily due to the special termination benefits of approximately $85,000, attributable to employees retiring in 1991 under this program.

The decrease in pension cost from 1989 to 1990 was primarily due to the adjustment of actuarial assumptions, offset partially by plan amendments.

Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" (Statement No. 87), requires a comparison of the actuarial present value of projected benefit obligations with the fair value of plan assets, the disclosure of the components of net periodic pension costs and a reconciliation of the funded status of the plans with amounts recorded on the balance sheet. Such disclosures are not presented for the Company because the structure of the Bell Atlantic plans does not allow for the determination of this information on an individual company basis.

The assumed discount rates used to measure the projected benefit obligation were 7.75% and 8.0% at December 31, 1991 and 1990, respectively. The assumed rate of future increases in compensation levels was 5.25% at December 31, 1991 and 1990. The expected long-term rate of return on plan assets was 7.5% for 1991, 1990 and 1989.

6. EMPLOYEE RETIREMENT BENEFITS (Continued)

Postretirement Benefits Other Than Pension (Continued)

Substantially all of the Company's management and associate employees are covered under postretirement health and life insurance benefit plans sponsored by Bell Atlantic and certain of its subsidiaries, including the Company. The determination of postretirement benefit cost for postretirement health benefit plans is based on comprehensive hospital, medical, surgical and dental benefit provisions. The postretirement life insurance benefit formula used in determination of postretirement benefit cost is primarily based on annual basic pay at retirement.

The Company funds for postretirement health benefits for associate employees and postretirement life insurance benefits for associate and management employees. The Company's objective in funding these plans is to accumulate funds at a relatively stable rate over participants' working lives so that benefits are fully funded at retirement. Plan assets consist principally of investments in domestic and nondomestic corporate equity securities, and U.S. Government and corporate debt securities.

In 1991 the aggregate cost of postretirement health and life insurance benefits was $3.4 million.

Statement No. 106 requires a comparison of the actuarial present value of projected benefit obligations with the fair value of plan assets, the disclosure of the components of net periodic benefit costs and a reconciliation of the funded status of the plans with amounts recorded on the balance sheet. Such disclosures are not presented by the Company because the structure of the Bell Atlantic plans does not allow for the determination of this information on an individual company basis.

The assumed discount rate used to measure the accumulated postretirement benefit obligation was 7.75% at December 31, 1991 and 8.0% at January 1, 1991. The assumed rate of future increases in compensation levels was 5.25% at December 31, 1991. The expected long-term rate of return on plan assets was 7.5% for 1991. The medical cost trend rate in 1991 was approximately 15.0%, grading down to an ultimate rate in 2003 of approximately 5.0%. The dental cost trend rate in 1991 and thereafter is approximately 4.0%.

Certain other postretirement benefits other than pensions have been included in labor negotiations described above and such benefits have been modified from time to time. Additionally, the Company has amended the benefits under postretirement benefit plans maintained for its management employees. Expectations with respect to certain future amendments to the Company's postretirement benefit plans have been reflected in determining the Company's postretirement benefit cost under Statement No. 106.

During 1990 and 1989, the cost of postretirement health benefits was $3.0 million and $4.1 million, respectively. In addition, the Company recognized postretirement life insurance benefit cost for 1990 and 1989 in the amount of $54,000 and $175,000, respectively.

8. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarter	Total Operating Revenues	Net Operating Revenues	Income Before Cumulative Effect of Change in Accounting Principle	Net Income (Loss)
	(Dollars in Thousands)			
1991				
1st	$ 57,088	$ 18,559	$10,017	$(16,112)
2nd	58,206	18,156	9,915	9,915
3rd	58,035	16,078	8,496	8,496
4th	57,059	10,118	6,424	6,424
Total	$230,388	$ 62,911	$34,852	$ 8,723
1990				
1st	$ 56,383	$ 17,399	$ 9,038	$ 9,038
2nd	55,842	17,509	9,203	9,203
3rd	57,167	18,107	9,536	9,536
4th	57,082	16,387	9,023	9,023
Total	$226,474	$ 69,402	$ 36,800	$ 36,800

Results of operations for the first three quarters of 1991 have been restated for the effect of the adoption of Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (see Note 6). As a result of the restatement, net operating revenues decreased $183,000, $184,000 and $184,000, and income before cumulative effect of change in accounting principle decreased $100,000, $111,000 and $111,000, for the quarters ended March 31, June 30, and September 30, respectively.

Net income for the third and fourth quarters of 1991 was reduced by approximately $900,000 as a result of costs associated with the retirement incentive program and restructure initiative.

11. TRANSACTIONS WITH AFFILIATES

The Company has contractual arrangements with an affiliated company, Bell Atlantic Network Services, Inc. (NSI), for the provision of various centralized corporate, administrative, planning, financial and other services. These arrangements serve to fulfill the common needs of Bell Atlantic's operating telephone companies on a centralized basis rather than duplicating efforts in each company. In connection with these services, the Company recognized approximately $34.3 million, $28.9 million, and $24.8 million in operating costs in 1991, 1990 and 1989, respectively. Included in these costs were $3.3 million, $2.9 million and $2.9 million in 1991, 1990 and 1989, respectively, billed to NSI and allocated to the Company by Bell Communications Research, Inc., another affiliated company owned jointly by the seven regional holding companies. The NSI costs in 1991 also included $888,000 associated with NSI's adoption of Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (Statement No. 106). In addition, the Company recognized a $9.0 million net income charge for the Company's proportionate share of NSI's accrued transition obligation under Statement No. 106. The Company also paid a $19.2 million liability to affiliated telephone companies in 1991.

The Company has a contractual agreement with another affiliated company, Bell Atlantic Network Funding Corporation (BANFC), for the provision of short-term financing and cash management services. BANFC issues commercial paper to fund the working capital requirements of the operating telephone companies and NSI, secures bank loans, and invests funds in temporary investments on their behalf. In connection with this arrangement, the Company recognized interest expense of $113,000 and interest income of $85,000 in 1991. The corresponding interest expense in 1990 and 1989 was $127,000 and $193,000, respectively, and the corresponding interest income was $81,000 and $295,000, respectively.

Prior to 1990, Company officers were also officers of Bell of Pennsylvania, another wholly-owned subsidiary of Bell Atlantic. Also, Bell of Pennsylvania employees performed certain operations for the Company, including engineering, accounting and directory work. Arrangements existed between the companies under which Bell of Pennsylvania paid the salaries and expenses of these joint officers and employees and was reimbursed by the Company for its attributable portion of salaries and expenses. Under an organizational restructure in 1990, Company officers were no longer elected officers of Bell of Pennsylvania. However, certain Bell of Pennsylvania employees continued to perform some operations for the Company. The Company reimbursed Bell of Pennsylvania for these services which were provided under contractual agreements.

During 1991, building construction and maintenance engineering services provided by Bell of Pennsylvania were transferred to another affiliate, the Chesapeake and Potomac Telephone Company of Maryland. The Company reimbursed the affiliate company for these services which were provided under contractual agreements.

THE DIAMOND STATE TELEPHONE COMPANY
SCHEDULE V – PLANT, PROPERTY AND EQUIPMENT
FOR THE YEAR ENDED DECEMBER 31, 1991

(Dollars in Thousands)

Column A	Column B	Column C	Column D	Column E	Column F
Classification	Balance at Beginning of Period	Additions at Cost Note (a)	Retirements Note (b)	Other Changes	Balance at End of Period
Land	$ 2,964	$ 5	$ --	$ --	$ 2,969
Buildings	37,711	1,383	137	--	38,957
Central Office Equipment	233,205	23,526	10,884	--	245,847
Telephone Instruments and Related Equipment	17,111	1,944	713	--	18,342
Pole Lines	7,978	408	156	--	8,230
Cable and Wiring	267,567	14,625	3,613	--	278,579
Conduit	38,777	2,056	70	--	40,763
Office Equipment and Furniture	5,205	789	204	--	5,790
Vehicles and Other Work Equipment	6,100	1,730	585	--	7,245
Other	888	267	--	--	1,155
Total In Service (c)	617,506	46,733	16,362	--	647,877
Plant Under Construction	8,931	4,183	--	--	13,114
Other	245	--	--	--	245
Total Plant, Property and Equipment	$ 626,682	$ 50,916	$ 16,362	$ --	$ 661,236

The notes on page F-29 are an integral part of this Schedule.